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Gardin, John Emile

Commercial letters of credit

New York

1915

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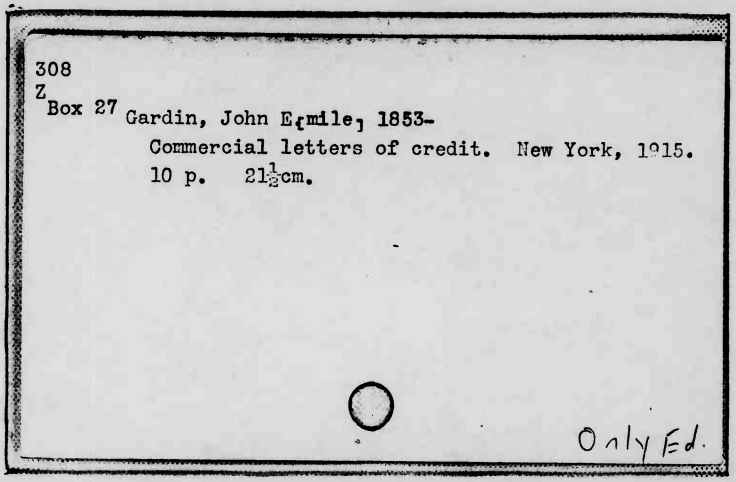

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Commercial Letters of Credit

John E. Gardin

Commercial Letters of Credit

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The National City Bank
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New York
1915

M22-31-1916-BB.

308
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Box 27

COMMERCIAL LETTERS OF CREDIT

Acceptances by National Banks under the Federal Reserve Act.

IMPORT

National Banks are permitted to accept time bills, provided the transaction involves the importation or the exportation of merchandise. The law is silent on the point as to the country from which the merchandise is to be imported or to which it is to be exported, but the natural inference is that it only applies to imports to and exports from the United States of America.

A strict interpretation of the law would be that each acceptance must cover a distinct transaction from its incipiency to its final conclusion; such an interpretation, however, would seriously restrict the practical working of the Act and in effect would render it most inefficacious and practically nullify the purpose for which it was created.

A recent ruling of the Federal Reserve Board provides that where the funds resulting from acceptances are intended to produce the merchandise for ultimate export, or where such funds are to be applied to the purchase

NOTE.—The terms "Bank" and "Banker" are used indiscriminately in this paper and should be considered as synonymous.

of goods to be shipped abroad from the United States, the acceptance privilege on the part of national banks can be invoked. This ruling gives the application of the law a much wider scope and is extremely beneficial.

The law covers two distinct features.

1st. The importation of merchandise to the United States.

2nd. The exportation of merchandise from the United States to foreign countries.

The method of procedure in the first case is somewhat as follows:

An American merchant desires to import a foreign product into the United States. The conditions of the market in which he makes his purchase calls for a confirmed Bankers Credit on New York. He therefore obtains from his banker an undertaking commonly known as a Commercial Credit, authorizing the party from whom he purchases the goods to draw upon said Banker for the value of the Invoice amount in accordance with the terms of the sale. These terms vary according to the particular country, but generally comprise the following features.

I. Approximate amount of Invoice.

II. Evidence of shipment. This feature is covered by bills of Lading, properly signed, either by the Master of the vessel conveying the goods or by a firm acting as the Agents of the Ship owners (and generally recognized as such) or by the Company itself as owners of the respective vessels.

Bills of lading are issued in sets of two or more and contain a provision designating the number of instruments

issued and declaring that any one of them being accomplished, the others ipso facto become null and void. Terms of sale are either "c.i.f."; that is, cost, insurance and freight to destination; (in other words, vendor delivers the merchandise free of cost at port of destination, paying cost of merchandise, insurance and freight, and makes delivery at the end of ship's tackle, where his responsibility ceases) or f.o.b.; that is, free on board at point of embarcation. This latter condition calls for payment of merchandise on the part of purchaser on delivery in the hold of vessel, whereupon the responsibility of the vendor ceases. Freight and insurance is also paid by purchaser. Freight as a rule follows the goods, but under certain circumstances must be prepaid, in which event it is added to the invoice.

III. Particular requirements of law or of the trade; e.g., certificate of analysis, certificate of origin, certificate of inspection, certificate of weight, guaranty of producer that the goods conform to the laws governing pure food products, and other specific certificates, may be required.

IV. Insurance Certificates.

V. Consular Invoice.

Such a credit can be opened by cable or the regular credit instrument can be forwarded by mail.

In the first case, all the details must be cabled out to a bank or banker at the domicile of the vendor, authorizing said bank to negotiate the vendor's draft drawn at 60 or 90 days sight on an American bank under the specific conditions governing the transaction. Of course this is an expensive method

of transacting such business, but where time is the essence of the transaction, expense is disregarded. The expense, however, may be greatly modified by prearranging certain cipher symbols covering the details of the transaction and this is the general practice.

Where the credit is transferred by mail, a regular letter of credit is made out duly signed by the officers of the bank, setting forth all the details of the operation. It sometimes happens that the vendors of merchandise having an agent or a branch office in the city where the purchaser is located, require that the regular instrument be delivered by the purchaser to the vendor's agent, who then, under a prearranged method cables his house that he is in possession of the Letter of Credit and is thus enabled to negotiate the drafts thereunder. Of course, in this event, the standing of the beneficiary must be such that his word is taken by the local banks in regard to the bona fides of the transaction.

With a document of this character in his possession, the merchant vendor negotiates his drafts with the required documents attached through a local banker, and is thus immediately placed in funds, without any further responsibility on his part as to recourse in the event of the purchaser becoming insolvent in the meantime, as that is a matter that concerns only the banker granting the credit.

The accepting bank makes a charge for this service, which is governed by the standing of the parties for whose account the credit is opened, and which also in a certain measure is regulated by competition.

Drafts drawn under a Commercial credit are forwarded by the bank or banker negotiating them to its local correspondent, who presents them to the accepting bank with the documents attached. As a rule, the first of exchange is forwarded by one steamer and the second of exchange together with duplicate documents forwarded by another steamer. Occasionally, the main documents, that is, sufficient to make the Custom House entries, are forwarded either by the vendor or by the bank negotiating the draft, according to arrangement, to the city to which the steamer carrying the goods is consigned, where port of destination is other than the domicile of the accepting banker, in order to prevent delays in clearing the merchandise through the Custom House. When this is done, however, an advice or a certificate over the signature of the beneficiary or the banker negotiating the draft, as the case may be, accompanies the first of exchange so as to assure the accepting bank that the essential documents have been properly disposed of.

The conditions under which these credits are issued vary according to the standing of the party for whose account they are issued. Occasionally the arrangement is that the documents are held by the accepting bank and only delivered to the purchaser of the goods upon payment of the invoice value or against deposit of security; or, under arrangement, where the parties are in good credit standing, they are delivered under a so-called Trust Receipt, which obligates the purchaser to turn the proceeds into the bank after sale of the goods to be used in liquidation of the amount of the acceptance.

The main provisions of the Trust Receipt, however, are observed more in the breach than in the performance.

As a matter of fact, while the title to the goods, which are in the purchaser's hands, is supposed to remain in the name of the accepting bank, the fact is that the bank virtually loses its title thereto by the circumstance that the goods are generally taken into the purchaser's warehouse and there mingled with other goods thereby making it practically impossible to follow up and identify the merchandise.

EXPORT

When the provision in the Federal Reserve Law covering acceptances on the part of National Banks was first promulgated, the particular feature granting the privilege of acceptance where the export of merchandise was involved called forth considerable criticism and was regarded as a superfluous measure and many otherwise well informed persons conjectured in what manner this privilege could be exercised.

The method is very simple and is just as advantageous to the American Banking community as the right of acceptance where the import of merchandise to the United States is involved.

It simply reverses the position and places the Amercan Banker on a parity with his European confreres.

A foreign merchant desiring to purchase goods in the United States obtains from his Banker a commercial Letter of Credit prescribing that drafts in liquidation of his purchases in America should be drawn on a Bank in

New York or elsewhere, at sixty or ninety days sight with proper documents attached. This transaction would then lie between the accepting American Bank and its European correspondent and is similar in all respects to the credit in favor of the merchant desiring to import merchandise. It can be carried even further than that under the recent ruling of the Federal Reserve Board, that an American merchant desiring ultimately to export merchandise can, under proper arrangements with his Banker, draw on time in anticipation of the actual export, using the funds in the purchase or preparation of his shipment, and when ready actually to export, use the proceeds of the drafts that he draws on the buyer or the buyer's Banker in liquidation of the acceptance. This method has been very extensively used during the present European war and has served its purpose admirably, and due credit must not be withheld from the Federal Reserve Board for giving an intelligent and practical interpretation to the law.

The greatest benefit that will accrue to the country lies, not alone in the additional means to promote commerce, but to the circumstance that a means is provided to protect our gold supply by furnishing a discount market which, without these acceptances, would be impossible.

This advantage must not be underestimated as it is an essential to the growth of the commercial life of the nation. At the present time, there is no pressing necessity for additional means of expanding credit, but the nation from a financial standpoint is in a

formative stage, and while this may create a redundancy in money matters at present, the greater advantage must be recognized in the education of our bankers to a method of doing business that goes to the very heart of our commercial and banking existence.

Later on, under a full development of our business activities, we will not lose sight of the ultimate benefits but will be glad to take advantage of a banking method that will be of the greatest assistance to us, and will provide us with the means of meeting any emergency. With a discount market fully developed and with the wise provisions of the Federal Reserve law to fall back upon, we need never fear another panic, and the recrudescence of the days of 1893, 1903 and 1907 need not be apprehended.

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